




## COUNCILMEMBER CARL DeMAIO

FIFTH DISTRICT  
CITY OF SAN DIEGO

### MEMORANDUM

DATE: August 17, 2009

TO: Jay Goldstone, COO  
Mary Lewis, CFO

FROM: Councilmember Carl DeMaio 

RE: Updating the City's Five-Year Financial Forecast

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The City of San Diego's financial crisis stems from not one, but several growing financial obligations and liabilities. If the city were only facing one or two of these liabilities, a piecemeal approach may suffice. Unfortunately that is not the case. In fact, the city faces a "perfect storm" of liabilities – some of which are projected to crest in the next five years.

The only way to adequately address the city's financial problems is to view them in an integrated fashion – and to pursue financial reforms and organizational restructuring in a likewise integrated fashion.

To his credit, the Mayor created a Five Year Financial Forecast at the beginning of his tenure to guide his initial fiscal reform efforts. However, as recently noted by the Independent Budget Analyst, the forecast must be updated to reflect new economic realities and worsening financial obligations.

Moreover, the forecast should include the impact that proposed civic projects (e.g. Downtown Library, New City Hall, Convention Center, etc.) would have on the city's financial health.

To this end, I request that the following issues be fully and openly analyzed and included in the forthcoming Five Year Financial Forecast.

<b>Pension Liability</b>
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As the city struggles to service its approximate \$2 billion unfunded pension liability, the current Forecast methodology presents two potential "ARC" scenarios, largely reflecting the liability as determined by the SDCERS actuarial assumptions. This practice works for a reliable Forecast— but only if the ARC is calculated without manipulation of underlying assumptions.

The plan actuary has estimated the city's FY 2011 ARC payment at a staggering \$225 million, using the current actuarial assumptions and requirements. That payment is expected to spike to more than \$318 million by FY 2015 – reflecting an unsustainable level of 40% - 45% of payroll.

As you are aware, the SDCERS board has discussed ways to change the actuarial assumptions to artificially lower the annual ARC – masking recent market losses in the near-term. While that action may temporarily lower the FY 2011 pension payment, it comes at the cost of increases to future payments that include compound interest on foregone contributions.

Three key pension issues must be adequately treated in the Forecast if we are to provide the public with an accurate outlook on this liability.

First, I request that the Forecast present the ARC using the current actuarial methodology. If the SDCERS board changes the methodology, the numbers should be presented using a "before and after" approach so decision-makers and the general public can fully understand the implications to both our short-term and long-term financial obligations as a city.

Second, I request that the Forecast present two alternative scenarios for investment performance of the SDCERS fund. This represents important information, as the actuary for CALPERS recently testified that investment returns may not achieve stated benchmark goals for the next several years.

Due to current economic uncertainty, depicting a scenario with lower investment returns than the actuarial assumed rate of 7.75% for at least the next two years will allow the city to understand its forthcoming obligations in the event of a more gradual or lesser than expected market recovery.

Third, SDCERS has filed a lawsuit demanding an immediate payment of \$259 million stemming from the city's intentional under funding of the pension system under MP1 and MP2. Should the city's position not prevail in that lawsuit, please present the impact of that outcome over the next five years.

### **Retiree Healthcare**

While the city has made significant progress in recognizing its retiree health care liabilities, and the recent labor contracts outline a negotiation process on this issue with our labor unions, the city faces a staggering \$1.2 billion liability for retiree health care.

It is important that decision-makers are made aware of the values of forecasted ARCs, forecasted payment levels, and resulting annual UAL values for the retiree medical liability in a manner analogous to the pension plan. Please note whether negative amortization is occurring – or is planned to occur - on the retiree medical UAL. In addition, the Forecast should reflect two potential outcomes from the pending labor negotiations: A) the city is successful in implementing the reforms anticipated in the labor contracts, or B) the city and unions failed to reach agreement and the previously existing retiree health care policy and resulting levels of unfunded liability return to the city's balance sheet.

By presenting both potential outcomes in the Forecast, decision makers and the public can fully understand the importance of successfully achieving the Mayor's desired reforms in the upcoming labor negotiations.

### **Labor Contracts**

As with the temporary suspension of retiree healthcare cost inflation during negotiations described above, some of the labor contracts recently approved made the salary and benefit concessions of city employees temporary.

At the conclusion of the contract period, some of those salary and benefit concessions are automatically restored to city workers. For example, the "offset" payments - whereby city taxpayers have "picked up" the retirement contributions ordinarily paid by city employees - will return absent additional action by the Mayor and Council.

While your forecast may not build in pay increases for city workers, the forecast must assume the restoration of any temporary reductions.

In addition, the Police Officers Association has its "donning and doffing" lawsuit pending against the city. The forecast should include a best and worst case scenario for resolution of this claim.

**Existing Public Facilities: Petco Park, Convention Center, and Qualcomm Stadium**

Annual debt service payments for Petco Park are scheduled to revert to the General Fund after FY 2013 – resulting in an \$11.3 million hit to the General Fund. The Port is scheduled to end its contributions for Convention Center Phase Two debt service on June 30, 2014 – resulting in another \$4 million hit to the General Fund. These two forthcoming obligations should be reflected as part of the Five Year Forecast.

In addition, the City Auditor has raised concerns that the Chargers can exercise their contractual right to leave Qualcomm Stadium in 2011 – which would obligate the city to pay \$21 million for outstanding debt on the stadium. This possibility should be reflected in the Forecast.

**Planned Public Facilities: New City Hall, Downtown Library, etc.**

The city has a number of facilities slated to open in the next several years – and is also considering a number of large civic projects.

As a modification of the methodology in your initial Forecast, please include the cost of staffing and operating any new facilities with planned completion dates in the next five years.

In addition, please include the impact of approval of the following civic projects:

- Downtown Library: The City Council was never provided with a depiction of the negative financial consequences of the Downtown Library as it relates to the Five Year Forecast, even though this update was requested prior to the decision to move forward with a Letter of Intent with the San Diego Unified School District.

The city admittedly lacks the funds to a) build the current project and b) staff the library. As it relates to the library, it is my understanding that the annual debt service that CCDC will pay for this project amounts to approximately \$9 million.

Additionally, boosters of the project claim they will raise monies to cover the shortfall for construction – and hope to cover \$10 million of the shortfall for operating expenses. The IBA has raised concerns that even this amount may not cover the increased operating expenses for the facility.

To provide further transparency on the level of financial risk associated with undertaking this project, please present a Forecast that assumes two outcomes: one where fundraising covers project costs and one where only 50% of the fundraising target is met above the commitments currently in hand.

- New City Hall: Perhaps even more importantly, the impact to the City's finances of building a new City Hall must also be included in the Five Year Financial Forecast.

In a change from what has been presented to the general public and the City Council to date, an overview of the proposed Exclusive Negotiating Agreement (ENA) with Gerding Edlen notes that a "[s]maller City Hall building" is a "likely outcome" of the ENA process.

This notion casts significant doubt over the validity of the "Master Lease" offset – a lynchpin of the CCDC financial forecasts used to attain "savings" by building a new City Hall. The importance of the Master Lease offset to the new City Hall proposal cannot be understated, as the CCDC/JLL financial models assume it provides the city with approximately \$7.4 million of annual income, reducing the project cost by a nominal total of \$71.8 million over the first 15 years.

As such, the Forecast should present two alternatives: one with a new City Hall (with adjusted master lease benefits) and one without a new City Hall.

#### **State Budget & Redevelopment Agency Impact**

State budget difficulties continue to threaten the finances of local jurisdictions throughout California, including the City of San Diego. Furthermore, given the heavy reliance upon accounting gimmicks to balance the State's budget, it remains highly unlikely that this threat to local government coffers will subside in the near future.

The Five Year Forecast should provide a projection of State impacts to the City's finances, perhaps utilizing a sensitivity analysis to provide decision-makers with a "best case" and "worst case" depiction of the financial relationship between the State and the city in the coming years.

In addition, please analyze the combined impact of the state raid of redevelopment dollars and the anticipated repayment of CDBG funds as part of the city's settlement with the Department of Housing and Urban Development. Specifically, it is quite possible that projects currently funded through Redevelopment dollars (e.g. Downtown Library, Petco Park debt service, etc.) may have to be transferred back to the General Fund.

#### **Storm Water and Secondary Treatment of Wastewater**

My office recently inquired as to the estimated value of the city's future costs for storm water compliance, including EPA requirements in addition to the city's municipal permit. This forthcoming estimate of annual expenditure (as well as estimated impact on forthcoming liability) should be acknowledged in the Forecast.

While not a General Fund obligation, the Forecast should outline the fiscal impact to San Diegans in the event that the city is required to move to Secondary Treatment for its wastewater system, as this would have a significant impact on ratepayers.

#### **Deferred Maintenance**

My office has recently suggested a more expansive methodology for calculating and presenting the city's Deferred Maintenance obligations. While representing an ongoing endeavor, deferred maintenance should ideally be treated in a fashion (mathematically) analogous to the retiree medical obligation or pension liability. The funding plan for deferred maintenance should be included in the 5 Year Forecast, with a discussion of the forecasted impact to the most recent estimate of the city's deferred maintenance backlog.

#### **Other Liabilities: (Public Liability, Workers Compensation Liability, ADA Projects)**

The anticipated annual financial burden *and* annual impact to the obligations associated with each of these liabilities should be acknowledged in the updated Forecast.

#### **Annual Outlay View vs. Net Liability View**

As reflected in each liability category, it is my hope that the updated forecast shows not only the annual financial impact from each liability, but also the total net change in the liability.

For example, an individual may alter his or her monthly payment on a credit card – simply examining monthly payments would be analogous to an annual outlay view. However, the running balance of debt on the card itself is missing entirely from this view. Similarly, the current methodology for calculating and presenting the city's Forecast omits a more comprehensive net liability view.

It is vital that the Forecast present the annual net running total for each liability in addition to the annual change in outlay currently provided.

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The Mayor's Office is to be highly commended for the development of its initial Five Year Financial Forecast approach. However, the next revision should mature the methodologies used in the Forecast to provide decision makers and the public with the most accurate and useful financial information possible.

My office stands ready to assist in any way possible in the development of this improved Forecast for the city.

CC: Mayor Jerry Sanders  
Andrea Tevlin, Independent Budget Analyst  
City Councilmembers